United States Court of Appeals

for the Second Circuit

APPENDIX

NO. 75-6136

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SCUTH WINDSOR CONVALESCENT HOME, INC.,

Plaintiff-Appellee,

v.

DAVID MATHEWS, Secretary of Health,
Education and Welfare, et al.,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF CONNECTICUT

A P P E N D I X

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PAGINATION AS IN ORIGINAL COPY

I N D E X

CIVIL DOCKET

UNITED STATES DISTRICT COURT

Jury demand date:

H74 250

D. C. Form No. 106 Rev.

TITLE OF CASE	ATTORNEYS
SOUTH WINDSOR CONVALESCENT HOME, INC. vs CASPAR WEINBERGER, SECRETARY OF HEALTH, EDUCATION AND WELFARE, THE UNITED STATES OF AMERICA, AND TRAVELERS INSURANCE COMPANY, MEDICARE FISCAL INTERMEDIARY	For plaintiff: Arnold W.Aronson Esq. tel. 278-[illegible] 111 Pearl St. Hartford,Conn. tel. 246-8525 For defendant: Henry Cohn (both defendants)) 450 Main St. Hartford, Conn. 06103

STATISTICAL RECORD	COSTS		DATE 1974	NAME OR RECEIPT NO.	REC.	
J.S. 5 mailed	Clerk		8-16	A.Aronson	$15 00	
			8/23	Deposit		15
				(G.F. 100869)		
J.S. 6 mailed	Marshal					
Basis of Action: Seeks damages; action pursuant to Title 28 Soc. Security Act. 42 U.S.C. &1395 et sec.(Medicare Program)	Docket fee					
	of the					
	Witness fees					
Action arose at: alleges def. illegal in recapturing accelerated depreciation allowance permitted under prior regulations.	Depositions					

-1a-

DATE 1974	PROCEEDINGS	Date Order Judgment No.
8-16	1. Complaint filed. Summons issued and together with same and copies of complaint (6) handed to Marshal for service.	
8-30	2. Marshal's return showing service.	
10-1	3. Stipulation filed that defendant have until 12-1-74 to answer or otherwise plead to the complaint. Ordered Accordingly, Markowski, C. m 10-2-74. Copies mailed to counsel.	
10-15	4. Appearance of Henry Cohn entered for the defendant	
	5. Answer filed by def. Sec. of HEW.	
10-24	6. Amended Answer filed.	
1975		
1-27	7. Defendants Motion for summary judgment.	
	8. Defendants Memorandum in support of motion for summary judgment.	
"	9. Affidavit of Manuel Levine.	
2-24	10. Pltf. Motion for Summary Judgment.	
2-27	11. Plaintiff's Memorandum for Summary Judgment.	
"	12. Affidavit of Francis F. Ronan.	
3-17	HEARING on Pltf. Motion for Summary Judgment. Decision Reserved.	
6/3	Court Reporter's Notes of Proceedings held on March 17, 1975, filed in Hartford. (Sperber, R.)	
7-17	13. Ruling on Cross-Motions for Summary Judgment, Clarie, J. m 7-18-75. Copies mailed to counsel.	
10-16	14 JUDGMENT, entered. Clarie, J m10 17-75 Copies mailed to counsel.	
10-21	15 Corrected Judgment, Clarie, J. m 10 21-75. Copies mailed.	
12-12	16. Notice of Appeal filed by deft. U.S.A. Attested copies of docket entries and notice of appeals mailed to U.S. Court of Appeals and New Haven. Copy mailed to Atty Aronson, Management Appeals Plan and Forms C & D. given to U.S. Atty.	

A True Copy
ATTEST:

[illegible] MARKOWSKI
Clerk, U. S. District Court

By: Anne M Greco
Deputy Clerk

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

SOUTH WINDSOR CONVALESCENT HOME, INC.

Plaintiff,

vs

CASPAR WEINBERGER, SECRETARY OF HEALTH, EDUCATION AND WELFARE, THE UNITED STATES OF AMERICA, AND TRAVELERS INSURANCE COMPANY, MEDICARE FISCAL INTERMEDIARY

CIVIL NO. H74 250

Defendants,

COMPLAINT

1. Plaintiff is a Connecticut corporation with its principal office and place of business in the Town of South Windsor, County of Hartford and State of Connecticut.

2. Defendant, Travelers Insurance Company, Medicare Intermediary, is a Connecticut corporation with its principal office and place of business in the Town and County of Hartford and State of Connecticut.

3. Defendant, Caspar Weinberger, (hereinafter "Secretary") has official residence in the District of Columbia, and is the Secretary of Health, Education and Welfare of the United States of America. Defendant Secretary is sued solely in his official capacity.

4. The amount in controversy exceeds $10,000.00 exclusive of interest and costs.

5. Title XVIII of the Social Security Act, 42 U.S.C., Sections 1395, et sec., commonly referred to as the Medicare program, is a federally funded health insurance program for the aged designed to provide health care services to qualified beneficiaries. The program is administered and funds are disbursed to the providers of those services in large part through state agencies and private organizations designed by the Social Security Administration as fiscal intermediaries. Under Medicare, post-hospital extended care is available to eligible beneficiaries in skilled nursing facilities such as those operated by the plaintiff in this action.

6. Participation in the Medicare program as a skilled nursing facility requires that a nursing home be certified by the appropriate state agency as being in compliance with various health, safety, and environmental standards. In addition, the nursing home must execute a provider agreement with the Secretary of Health, Education and Welfare.

7. The provider agreement incorporates the provisions of Title XVIII that payments to a skilled nursing facility by the fiscal intermediary for services related to the patient care of an eligible Medicare beneficiary are to be the reasonable cost of those services (42 U.S.C. Sections 1395f(b) and 1395x(v).

8. From November 22, 1966, until August 1, 1970, the provider reimbursement regulations (20 C.F.R. Subpart D of Part 405, Sections 504.401-.454, 31 Fed. Reg. 12808) issued pursuant to Title XVIII by the Social Security Administration, and applicable to nursing homes, recognized an allowance for accelerated depreciation on capital assets as a reimbursable cost. Those regulations were effective for all cost reporting periods after January 1, 1967.

9. Under those regulations nursing homes were given the option of using the straight-line, the declining balance, or the sum-of-the-years-digits methods of depreciation, and were permitted to use one of these methods of depreciation on a single asset or group of assets and another method on other assets. Reimbursement to nursing homes for accelerated depreciation allowances was determined by the fiscal intermediaries as an element of reasonable cost for the services rendered. Final settlements approving these amounts of reimbursement were made by the fiscal intermediaries with the providers for the years involved. No provision existed in the regulations for a recovery of accelerated depreciation allowances upon a decline in a provider's participation in the program or withdrawal from the program.

10. The Social Security Administration and the fiscal intermediaries approved these accelerated methods of depreciation for determining the useful life of an asset and openly encouraged their use as an acceptable accounting practice to enable nursing homes to obtain amounts of reimbursement that were sufficient to meet the principal amortization schedules for financing new construction, the expansion of existing facilities, and other expenses related to their participation in the Medicare program.

11. Beginning in 1969, the Secretary of Health, Education and Welfare, through the fiscal intermediaries, began to cause the reduction of Medicare admissions to nursing homes by the imposition of more restrictive beneficiary eligibility requirements. This action resulted in substantial reduction in the number of Medicare patients eligible to receive skilled nursing care.

12. On August 1, 1970, the provider reimbursement regulations for Medicare were amended, in part, to delete an allowance for accelerated depreciation on capital assets acquired after that date, and by the addition of Section 405.415(d)(3) (20 C.F.R. Section 405.415(d)(3)), which provides:

> When a provider who has used an accelerated method of depreciation with respect to any of its assets terminates participation in the program, or where the health insurance proportion of its allowable costs decreases so that cumulatively substantially more depreciation was paid than would have been paid using the straight-line method of depreciation, the excess of reimbursable cost, determined by using accelerated depreciation methods and paid under the program over the reimbursable cost which would have been determined and paid under the program by using the straight-line method of depreciation will be recovered as an offset to current reimbursement due or, if the provider has terminated participation in the program, as an overpayment. In this determination of excess payment, recognition will be given to the effects the adjustment to straight-line depreciation would have on the return on equity capital and on the allowance in lieu of specific recognition of other costs in the respective years. (Emphasis added.)

13. Accelerated depreciation on capital assets could continue to be taken if the method had been in use prior to August 1, 1970, or if the financial commitments involved were made prior to February 1, 1970, or if the provider did not have an adequate cash flow from depreciation to meet amortization schedules on capital debts.

14. The provision of the regulations to the recapture of accelerated depreciation allowances were interpreted by the fiscal intermediaries as not requiring a recapture of depreciation allowanced paid in excess of straight-line amounts for periods prior to August 1, 1970, the effective date of the new regulation, because the original regulation specifically authorized the use of accelerated methods and the payment of those allowances as items of reasonable cost reimbursement.

15. Subsequently, in May of 1972, over one and one-half years after the effective date of the regulation and over two years after its issuance in proposed form, the Bureau of Health Insurance of the Social Security Administration issued a proposed revision of its Provider Reimbursement Manual for fiscal intermediaries ostensibly to implement the new depreciation regulation. Under this proposed manualization of the regulation, a recovery of accelerated depreciation allowances for all cost reporting periods, in which they were claimed was called for when a provider terminated participation in the Medicare program after July 31, 1970. Accelerated depreciation allowances paid to providers who terminated program participation prior to August 1, 1970 were not subject to recovery.

16. Fiscal intermediaries thereafter began to recapture accelerated depreciation allowances previously paid or determined to be owed to nursing homes as a reimbursable cost for all cost reporting periods in which accelerated depreciation was claimed, which resulted in a retroactive application of the regulation for periods prior to its effective date. No determination was made that those allowances were in fact unreasonable costs.

17. Subsequently, the Bureau of Health Insurance of the Social Security Administration further amended the methods to be used by a fiscal intermediary in determining whether accelerated depreciation allowances should be recaptured with the issuance of Provider Reimbursement Manual Revision (HIM-15), dated October, 1973. That manualization of the regulation provides, in part, that accelerated depreciation allowances are to be recovered if a provider has terminated participation in the Medicare program after July 31, 1970. Recovery is made for all cost reporting periods in which accelerated depreciation was claimed.

18. This recovery of the accelerated depreciation allowances is made by withholding amounts due providers from current Medicare reimbursement payments and by withholding mounts due providers from current payments owed them as providers of services under Title IXIX of the Social Security Act, 42 U.S.C., Sections 1396 et seq., commonly referred to as the Medicaid program.

19. The plaintiff has participated in the Medicare program as a properly certified provider of skilled nursing care since June 29, 1967, pursuant to a provider agreement with the Secretary of Health, Education and Welfare, which had been renewed annually. On October 1, 1971, the plaintiff terminated its participation in the Medicare program voluntarily.

20. On March 13, 1973, Travelers Insurance Company, the fiscal intermediary through which the plaintiff received its federal Medicare payments, notified the plaintiff that it was recapturing $34,324.00 in allowances determined to be owed to the plaintiff for accelerated depreciation in excess of straight-line amounts for the fiscal years ending September 30, 1967 through September 30, 1971 as follows:

Fiscal year ending	
September 30, 1970	$ 1,485.00
September 30, 1971	32,839.00
TOTAL	$34,324.00

21. The above amounts were recaptured from the plaintiff by the fiscal intermediary by payments made by the plaintiff under threats of suspension of federal payments under Title XIX of the Social Security Act. No determination was made by the fiscal intermediary that these amounts of reimbursement were in fact unreasonable.

22. The above allowances for accelerated depreciation were lawfully claimed by the plaintiff during the time involved under the applicable Social Security Administration regulations.

23. The recapture of accelerated depreciation allowances from the plaintiff by the Social Security Administration through Travelers Insurance Company under section 405.415(d)(3) was triggered by the plaintiff's voluntary termination in the Medicare program on October 1, 1971.

24. The actions of the Social Security Administration and its agents in retroactively recapturing accelerated depreciation allowances previously paid are unlawful in that they constitute a deprivation of property without due process of law in violation of the fifth amendment of the United States Constitution.

25. Section 405.415(d)(3) of the provider reimbursement regulations under which accelerated depreciation allowances were recaptured retroactively is arbitrary and capricious, and violative of the fifth amendment to the United States Constitution in that it authorizes the deprivation of property without due process of law.

26. Section 405.415(D)(3) of the provider reimbursement regulations under which accelerated depreciation allowances are recaptured for periods prior to the effective date of the regulation is void and unlawful because it is without statutory authority.

27. Section 415.415(d)(3) of the provider reimbursement regulations impairs provider contracts in violation of the due process clause of the fifth amendment to the United States Constitution.

28. Section 405.415(d)(3) of the provider reimbursement regulations under which accelerated depreciation allowances were recaptured is void and unlawful because it may not be applied retroactively as it would conflict with a regulation to the contrary which was in effect for the years in question, in violation of the due process clause of the fifth amendment to the United States Constitution.

29. Section 405.415(d)(3) of the provider reimbursement regulations under which accelerated depreciation allowances were recaptured is void and unlawful because it violates other Medicare regulations (including 20 C.F.R., Section 405.499g) which prohibit reopening the determination of the amount of Medicare reimbursement.

30. Wherefore the plaintiff respectfully demands judgment in its favor in the amount of $34,324.00 plus interest and costs.

Dated at Hartford, Connecticut, this 1st day of August, 1974.

Arnold W. Aronson
Attorney for
South Windsor Convalescent
Home, Inc.
37 Lewis Street
Hartford, Connecticut 06103

SUMMONS IN A CIVIL ACTION

CIV. 1 (2-64)
(Formerly D. C. Form No. 45 Rev. (5-49))

United States District Court

FOR THE

DISTRICT OF CONNECTICUT

CIVIL ACTION FILE NO. H-74-250

SOUTH WINDSOR CONVALESCENT HOME, INC.

Plaintiff

v.

CASPAR WEINBERGER, SECRETARY OF HEALTH, EDUCATION AND WELFARE, THE UNITED STATES OF AMERICA, AND TRAVELERS INSURANCE COMPANY, MEDICARE FISCAL INTERMEDIARY

Defendant

SUMMONS

To the above named Defendants :

You are hereby summoned and required to serve upon Arnold W. Aronson, Esq.

plaintiff's attorney , whose address is: 37 Lewis Street, Hartford, Connecticut 06103

an answer to the complaint which is herewith served upon you, within 60 days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

SYLVESTER A. MARKOWSKI
Clerk of Court.

8/16/74 Gabe R. A. Hansen
Deputy Clerk.

Date: August 16, 1974

[Seal of Court]

G. Hansen CLERK

NOTE:—This summons is issued pursuant to Rule 4 of the Federal Rules of Civil Procedure.

IN THE UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF CONNECTICUT

In The Matter Of: South Windsor Convalescent Home, Inc. Plaintiff v. Caspar W. Weinberger, Secretary of Health, Education, and Welfare; The United States of America; and Travelers Insurance Company, Medicare Fiscal Intermediary Defendants	Civil Case No. H-74-250

AFFIDAVIT OF MANUEL LEVINE

COUNTY OF BALTIMORE)
)ss
STATE OF MARYLAND)

I, Manuel Levine, being duly sworn, depose and say as follows:

(1) I am the Assistant Bureau Director, Division of Technical Policy of the Bureau of Health Insurance of the Social Security Administration to which the Secretary of Health, Education, and Welfare (hereinafter referred to as the Secretary) has delegated authority (42 U.S.C. 405) for the administration of the program of health insurance in title XVIII of the Social Security Act (42 U.S.C. 1395 et seq.). To the best of my knowledge and belief the facts hereinafter set forth in this affidavit are supported by information in the possession of the Social Security Administration and the Travelers Insurance Company of Hartford, Connecticut (hereinafter referred to as Travelers).

(2) Pursuant to an agreement entered into in July 1967, with the Secretary, under the provisions of section 1866 of the Social Security Act, South Windsor Convalescent Home, Inc. (hereinafter referred to as South Windsor) was certified as a participating provider under title XVIII of the Social Security Act (popularly referred to as the Medicare program).

(3) Travelers, having been nominated by a group of providers of services which included South Windsor entered into an agreement with the Social Security Administration pursuant to the provisions of section 1816 of the Social Security Act to perform for the Secretary designated functions in the administration of Part A of the Medicare program.

(4) As a participating provider of services under the Medicare program, South Windsor was required to file cost reports with the fiscal intermediary, Travelers (see 20 C.F.R. 405.406(b)) so that the latter could determine the "reasonable cost" of furnishing services to Medicare beneficiaries (section 1814(b) of the Social Security Act).

(5) South Windsor participated in the Medicare program until October 1, 1971, at which time it voluntarily terminated its participation in the program. A dispute arose between South Windsor and Travelers over Travelers' final cost settlement determination regarding an adjustment for depreciation on cost reports for 1967 through September 30, 1971. Travelers disallowed and off-set the excess of depreciation expenses computed and previously allowed by using the accelerated method over the reimbursable costs which would have been determined and paid under the Medicare program by using the straight-line method of depreciation. Regulations (20 C.F.R. 405.415(d)(3)) require that the excess of such amounts "will be recovered as an offset to current reimbursement due or, if the provider has terminated participation in the program, as an overpayment." This decision was communicated fully to the plaintiff in exit conferences on June 5, 1972 and July 25, 1972.

(6) Depreciation is considered an allowable cost under the program in recognition of the fact that certain assets are used up in providing services to program beneficiaries. While program regulations allow different interim methods of calculating the depreciation, a determination of the amount due the provider for a particular reporting period is essentially an estimate, and total allowable depreciation can only be fixed with certainty after the asset has been disposed of or its useful life exhausted.

(7) Accelerated depreciation results in a proportionately higher allocation of depreciation in the early periods of an asset's depreciable life and proportionately lower cost allocations in later periods. If a provider enters the program when assets are new, uses accelerated depreciation and then terminates participation in the program prior to the periods when average depreciation (the straight-line rate) is paid, Medicare would, in the absence of an appropriate adjustment, pay a disproportionate amount toward depreciation of the provider's assets. This would violate basic congressional intent that the program pay providers the reasonable costs--and nothing more than the cost--of furnishing services to Medicare beneficiaries. Thus, the adjustment to straight-line depreciation helps insure that the program pays only its fair

share of costs, including a proper share of depreciation expense.

(8) What Medicare is correcting in the case of recovery of accelerated depreciation under regulations section 405.415(d)(3) is not the determination made by the intermediary in settling any particular cost report, but the cumulative depreciation paid for use of the assets by program beneficiaries during all of the years the provider participated in the program. Depreciation is a recognized cost item, representing a replacement of capitalized value of an asset from the time of its acquisition through the period of its life usefulness. Whatever method of computation of the amount of depreciation payable in a cost period is employed, the two factors which remain constant are the value of the asset fixed at the beginning of the depreciation period and the life use also established at that time. Whether the depreciation is computed on an accelerated basis or on any of the other methods of computation permitted under the regulations, the payments in total are designed to equate to the capitalization base. Thus, there is the inherent condition attaching to any accelerated method of computation that the provider is deemed to anticipate continuing participation in the Medicare program at least to the end of the expected life use of the depreciating asset. A corollary concept attaching to other than straight-line depreciation is that a provider's termination of participation in the program prior to the end of the expectedlife of a depreciating asset causes an overpayment to the provider as of the time of the termination. Any contrary rule would be at variance with section 1861(v)(1) of the Act, which provides, in pertinent part, that costs with respect to program beneficiaries may not be borne by individuals not covered by Medicare and, conversely, that costs attributable to the latter individuals may not be borne by the program. Thus, accelerated depreciation would be recoverable by operation of law even if section 405.415(d)(3) of the regulations had not been promulgated, and therefore the regulation simply clarifies the prior existing requirements of the program.

Manuel Levine

MANUEL LEVINE
Bureau of Health Insurance
Social Security Administration
Department of Health, Education,
and Welfare

Subscribed and sworn before me
this 7th day of February, 1974

NOTARY PUBLIC
My Commission Expires: 7-1-78

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

SOUTH WINDSOR CONVALESCENT HOME, INC.	:	
-vs-	:	Civil No. H-74-250
CASPAR W. WEINBERGER, Secretary of Health, Education, and Welfare, THE UNITED STATES OF AMERICA, and TRAVELERS INSURANCE COMPANY, MEDICARE FISCAL INTERMEDIARY	:	

RULING ON CROSS-MOTIONS
FOR SUMMARY JUDGMENT

This action has been submitted to the Court on cross-motions for summary judgment, pursuant to Rule 56, Fed. R. Civ. P. The parties concede that there are no genuine issues of material fact remaining and that each is entitled to judgment as a matter of law. Upon reviewing the pleadings, the affidavits and all other papers filed, the Court finds the issues in favor of the plaintiff and accordingly grants summary judgment in favor of the plaintiff.

Facts

The plaintiff, South Windsor Convalescent Home, Inc., has been a certified "provider" of skilled nursing services under the federally funded Medicare program since July, 1967. This health insurance program was primarily designed to provide post-hospital extended nursing care facilities

for the aged. The administration of the program and the Federal Government funds are disbursed through state agencies and private organizations designated as fiscal intermediaries, pursuant to Title XVIII of the Social Security Act, 42 U.S.C. §§ 1395 et seq.

From the commencement of the plaintiff-provider's participation in this program in July 1967, until August 1, 1970, the federal regulations applicable to all Medicare-certified nursing homes, (20 C.F.R. Subpart D of part 405, §§ 405.401-454, 31 Fed. Reg. 14808) authorized an accelerated depreciation of capital assets as an approved accounting procedure for computing reimbursable costs. The accelerated method permits the usefulness of capital assets to be depleted at a faster rate in the earlier years than in the later years.

These nursing facilities were given the optional choice of using the straight-line, the declining balance or the sum-of-the-years digit method for depreciating these capital assets. No conditional provision existed in the federal regulations then, which would authorize the Government at its discretion or otherwise, to recover at a later time, the accelerated depreciation deduction authorized on these items, if the nursing home should later decide to withdraw from the Medicare program. The plaintiff represents that the Social Security Administration not only approved, but

encouraged the use of these accounting techniques, as an acceptable practice designed to encourage the building of new plant construction and the expansion of existing facilities. However, in 1969, more restrictive eligibility rules for beneficiary-users of these nursing homes were adopted by the Government, which caused a sharp drop in the number of Medicare patients eligible to be cared for under the program.

The federal regulations were also administratively amended to eliminate the provision, which allowed for an accelerated depreciation of those capital assets, which were acquired after August 1, 1970; and the amended regulations further provided that this accelerated method of depreciation could no longer be used by nursing facilities which were newly certified under the Medicare program after the effective date of the new regulation. Said regulation, in fact, went even further, by inserting a penalty provision which declared that if a nursing home terminated its participation in the Medicare program, after the August 1, 1970 date, (20 C.F.R. § 405.415(d)(3) (1972)), the Government could recoup all past overpayments acquired by the "provider," through the accelerated depreciation of its capital assets. Without any prior finding that these depreciation allowances were unreasonable, the fiscal intermediaries for the Government proceeded to take steps to recapture these allowances from those nursing homes that had withdrawn from the program.

The plaintiff now claims that this attempt at an ex post facto enforcement of the new amendment to the regulations constituted an attempt to retroactively enforce a new regulation.

The parties agree that on October 1, 1971, the plaintiff nursing home voluntarily terminated its participation in the Medicare program. On July 12, 1972, the Government's fiscal intermediary, Travelers Insurance Company, notified the plaintiff that pursuant to 20 C.F.R. § 405.415(d)(3), it was requesting full payment of the $17,685.00, which represented the accelerated depreciation taken by the plaintiff in excess of the straight-line schedule of amounts for the fiscal years ending September 30, 1967 through September 30, 1971. Under threat of the Government's complete cutoff of federal financial participation in the Title XIX program, the plaintiff paid back, under protest, its adjusted claim of $16,367.45. It is the plaintiff's present claim that the new "provider" reimbursement regulations, § 405.415(d)(3) are void and unlawful. The plaintiff asserts that these new regulations do violence to the existing contract between the parties under the fifth amendment to the United States Constitution and deprive the plaintiff of its property without due process of law.

The Government's position, on the other hand, is that it was alway implicit in its regulatory authorization permitting accelerated depreciation, that the provider must remain in the program for the entire period of the useful life of the assets being depreciated. The Government also

claims that 42 U.S.C. § 1395x(v)91), which calls for regulations to "provide for the making of suitable retroactive adjustments" authorizes the depreciation recapture regulations which are now in question.

Issue

Is the Government entitled to recapture what it now claims are cost charges in excess of actual costs, which were previously computed and allowed after audit, under the Government's own approved accelerated depreciation cost accounting methods, as a result of a subsequent amendment to the regulations, giving the Government a retroactive recoupment authority over depreciable assets, whose useful life had not yet been wholly depleted?

Law

Under Title 42 U.S.C. § 1395x(v)(1)(A)(ii) Congress authorized the Secretary of Health, Education and Welfare to promulgate regulations defining items of allowable and reimbursable reasonable costs; and it further provided more specifically, that such regulations shall:

> "provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive."

From November 22, 1966 until August 1, 1970, the reimbursement regulations applicable to nursing homes, formally recognized the allowance of accelerated depreciation on capital assets, as a reasonable cost for reporting periods. In fact, nursing homes were authorized to elect one of three options: the straight-line depreciation, the declining balance or the sum-of-the-years-digit method of depreciation. A choice of these methods was permitted to be used on a single asset or group of assets; and a different method on other assets.

Fiscal intermediaries, such as the defendant, Travelers Insurance Company, were authorized by regulation to allow this accelerated depreciation as an element of reasonable cost, when determining final settlements with providers, at the end of each reporting period. Nothing in the existing regulations, prior to August 1970, authorized the Government to recoup any part of the previously audited and allowed depreciation on asset items as finally determined at the end of each reporting period. In no event was the Government given the right to recoup any such allowed depreciation, should the provider withdraw from the program prior to the itemized asset being fully depreciated.

On August 1, 1970, these reimbursement regulations were administratively amended, so as to limit the use of accelerated depreciation, as to those assets acquired after the effective date of the amendment. It also restricted previously acceptable accounting procedures, by declaring that if a provider terminated its affiliation with the program after

the effective date of the amended regulations, the Government would be entitled to recoup the difference between the depreciation taken under the accelerated formula and the straight-line method of depreciation, as an overpayment; 20 C.F.R. § 405.415(d)(3) 1972. The latter regulation provides:

> "When a provider who has used an accelerated method of depreciation with respect to any of its assets terminates participation in the program, or where the health insurance proportion of its allowable costs decreases so that cumulatively substantially more depreciation was paid than would have been paid using the straight-line method of depreciation, the excess of reimbursable cost, determined by using accelerated depreciation methods and paid under the program over the reimbursable cost which would have been determined and paid under the program by using the straight-line method of depreciation will be recovered as an offset to current reimbursement due or, if the provider has terminated participation in the program, as an overpayment. In this determination of excess payment, recognition will be given to the effects the adjustment to straight-line depreciation would have on the return on equity capital and on the allowance in lieu of specific recognition of other costs in the respective years."

Prior to August 1, 1970, the Medicare regulations neither qualified a provider's use of accelerated depreciation nor provided for recapture of any portion of such charges taken by a provider. The only retroactive adjustment previously authorized applied to billings for interim monthly payments which were declared to be subject to adjustments for overpayments or underpayments; but at the end of each reporting period the final reimbursable cost amount would be determined

by audit. If the Government had intended to reserve the right to recoup accelerated depreciation items, if the "provider" should withdraw from the program during the useful life of any such assets, it would have been a simple matter to have said so in the original regulation.

The Health, Education, and Welfare Agency with a full comprehension of Congressional policy, as it related to the reimbursement principles of the Social Security Act, had declared in the regulation as originally promulated, that accelerated depreciation of such capital assets was a reasonable and allowable cost deduction; and this was confirmed at the time of final audit for the fiscal years ending September 30, 1967 through August 1, 1970, the effective date of the amended regulation.

To change the rule now and attempt to reopen the audit approved amounts, constitutes an ex post facto redetermination of allowable costs. The agency had promulgated these regulations, which defined accelerated depreciation as an acceptable actual cost item; it had also declared it to be a reasonable cost item for providing services to health insurance beneficiaries covered under Title XVIII of the Act. This depreciation allowance is distinguishable from the depreciation principles normally ascribed to the useful life of the depreciable assets under the federal tax statutes. Title 20 C.F.R. § 405.417 makes clear that difference:

"(b) Application. Depreciation is allowable on assets being used at the time the provider enters into the program. This applies even though such assets may be fully depreciated on the provider's books or fully depreciated with respect to other third-party payers. So long as an asset is being used, its useful life is considered not to have ended, and consequently the asset is subject to depreciation based upon a revised estimate of the asset's useful life as determined by the provider and approved by the intermediary. Correction of prior year's depreciation to reflect revision of estimated useful life should be made in the first year of participation in the program unless the provider has used the optional method (§ 405.416), in which case the correction should be made at the time of discontinuing hte use of that method. . . ."

The defendants argue that regardless of the method of depreciation used, two factors remain constant, the value of the assets at the beginning of the depreciation period and the life use period. The overall payments are designed to ultimately equate with the capitalization base as established. The defendant contends that a "provider" entering the program when the assets are new, uses the accelerated depreciation and should it thereafter terminate its participation in the program prior to the time, when average depreciation (the straight-line) rate would be paid, Medicare would, in the absence of the amended recoupment rule, be paying a disproportionate share toward the depreciation of the provider's assets. On the other hand, it should be emphasized, that had the "provider" terminated its affiliation with Medicare and

sold its business prior to the effective date of the amended recoupment regulation, no such alleged over-payment could then have been recovered.

The attempted application of the rule is contrary to the guidelines promulgated for the time period within which the Government now seeks retroactive reimbursement. The plaintiff relied upon those rules governing the determination of the reasonable cost of services rendered. The defendants' present attempt to retroactively try to recapture accelerated depreciation, amounts to an attempt to appropriate ex post facto the plaintiff's earned property right, in violation of the fifth amendment to the United States Constitution.

The Act only contemplated a retroactive adjustment of the interim payments, which were based upon the provider's original estimated costs. However, once the fixed reasonable cost liability had been determined after the Agency's audit, in the absence of fraud or mistake, the adjusted and approved allowance should stand. The Government argues that even if the amended regulation had not been adopted, previously allowed accelerated depreciation after audit could still be recoverable by a subsequent determination of its unreasonableness, under generally accepted accounting rules.

The amended controversial regulation, 20 C .F.R. § 405.-415(d)(3), was obviously designed as a deterrent against those providers who might be tempted to terminate their continued participation in the Medicare program through the

imposition of a monetary punishment should they elect to do so. Title 42 U.S.C. § 1359x(v) is the source of the authority for this regulation and it does not authorize the Secretary to make retroactive corrective cost adjustments because of the act of termination. Such adjustments are only authorized where it is found that there exist economically inappropriate "methods of determining costs"; no such findings have been made here.

> "Retrospective legislation is generally not favored by the courts and where there is an open question of construction of a statute with respect to whether it should be applied retrospectively it will only be so applied where it clearly does not impinge upon constitutional protection. Duke Power Co. v. South Carolina Tax. Comm., 4 Cir., 81 F.2d 513, 516. And it is a sound principle of constitutional law that retroactive legislature in general will not be allowed to impair rights which can truly be said to be vested rights of a nature constituting property rights. Lynch v. United States, 292 U.S. 571, 54 S.Ct. 641, 78 L.Ed. 1434; Etor v. City of Tacoma, 228 U.S. 148, 156, 33 S.Ct. 428, 57 L.Ed., 773 . . . ." Seese v. Bethlehem Steel Co., 74 F.Supp. 412, 417 (D. Maryland 1947).

This controversy does not involve a disagreement over the provider's interim reimbursement cost report; the resolution of such an issue would be cognizable and provided for under the rules. Such a dispute would call for an audit and an administrative hearing on the question of a reimbursement determination under Title 20 § 405.490 et seq., C.F.R. That kind of issue would authorize a reopening, a redetermination

or correction by the intermediary, at any time within three (3) years from the original notice of program reimbursement or hearing decision. What we have here, on the other hand, is a unilateral change in administrative policy, after the reporting period audit had been finalized and the plaintiff's rights vested.

As a matter of policy, the Supreme Court has generally upheld a reasonable measure of retroactivity in administering the impact of Income Tax Statutes. It has found that the reasonableness of retroactivity may revert back to the commencement of the calendar year in which the statute was enacted.

> "As respects income tax statutes it long has been the practice of Congress to make them retroactive for relatively short periods so as to include profits from transactions consummated while the statute was in process of enactment, or within so much of the calendar year as preceded the enactment; and repeated decisions of this Court have recognized this practice and sustained it as consistent with the due process of law clause of the Constitution." United States v. Hudson, 299 U.S. 498, 500 (1937).

Also see, Shanahan v. United States, 447 F.2d 1082, 1084 (10th Cir. 1971).

Had the Government elected to reserve the right to recapture cost adjustments on any part of the authorized accelerated depreciation items, should the plaintiff later decide to terminate its participation in the program, while still possessing assets which had not been fully depreciated, it could have provided for this contingency when it adopted

the regulations. It chose not to do so. Absent such a provision in the regulations, to adopt such a principle at this late date and apply it in a retroactive manner, would leave the interest of the providers in securing payment for their services completed unprotected, whenever such questions might arise.

In an analogous situation where the Secretary attempted to recoup the payment of charges for items or services after a final determination of costs, the District Court said,

> "The challenged regulations were applied in this case to recoup payments made to plaintiff between 1966 and 1972 for items or services subsequently alleged to be excluded from Medicare coverage by Section 1862(a).
>
> . . . .
>
> "Because of the view we take on the issue of statutory authority, we need not reach the question of the constitutionality of the suspension regulations. Mount Sinai is entitled to judgment on the merits and to a permanent injunction prohibiting unauthorized efforts by the Secretary or his agents to recoup Medicare payments the hospital received prior to January 1, 1972, on the basis of a subsequent determination that the items or services rendered were excluded from Medicare coverage by Section 1862(a) of the Act." Mount Sinai Hosp. of Greater Miami, Inc. v. Weinberger, 376 F.Supp. 1099, 1134-1136 (S.D. Florida 1974).

> "Appellee is not penalized for anything it did in the past. The new Act applies prospectively only. So there is no possible due process issue on that score. As stated in Fleming v. Rhodes, 331 U.S. 100, 107, 'Federal regulation of future action based upon rights previously acquired by the person

> regulated is not prohibited by the Constitution. So long as the Constitution authorizes the subsequently enacted legislation, the fact that its provisions limit or interfere with previously acquired rights does not condemn it. Immunity from federal regulation is not gained through forehanded contracts.'" F.H.A. v. The Darlington, Inc., 358 U.S. 84, 91 (1958) (footnote omitted).

As Justice Holmes so well expressed the law in a divided opinion of the Supreme Court in Blodgett v. Holden, 275 U.S. 142, 149 (1927), (as modified in 276 U.S. 594 (1928):

> ". . . I think it tolerably plain that the Act should be read as referring only to transactions taking place after it was passed, when to disregard the rule 'would be to impose an unexpected liability that if known might have induced those concerned to avoid it and to use their money in other ways.'"

This Court, following the principle applied in tax cases, finds that Medicare regulation 20 C.F.R. § 405.415(d)(3) is unconstitutional as applied to the plaintiff. The amended regulation seeks to recapture reimbursement for accelerated depreciation charges, which were authorized and lawfully taken prior to the commencement of the calendar year in which the regulation was adopted and promulgated. Since the effective date of the regulation was August 1, 1970, (§ 405.415(h)), the Court finds that the accrued charges which were recouped by the defendants for the period prior to January 1, 1970, are unconstitutional, under the due process clause of the fifth amendment to the United States Constitution. See,

Hazelwood Chronic and Convalescent Hospital v. Weinberger, Civil No. 73-210 (D. Oregon, March 26, 1974).

The defendants may not lawfully recapture reimbursements for accelerated depreciation taken by the plaintiff from June 29, 1967 through December 31, 1969. Charges recouped subsequently, commencing with January 1, 1970, are found to be lawful. The parties shall compute and submit a proposed final judgment as to the amounts due the plaintiff, so as to carry out the findings of this decision.

SO ORDERED.

Dated at Hartford, Connecticut, this 17th day of July, 1975.

T. Emmet Clarie
Chief Judge

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U.S. DISTRICT COURT
HARTFORD, CONN.

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

SOUTH WINDSOR CONVALESCENT HOME, INC.	:	
v.	:	CIVIL NO. H-74-250
CASPAR W. WEINBERGER, Secretary of Health, Education and Welfare, THE UNITED STATES OF AMERICA, and TRAVELERS INSURANCE COMAPNY, MEDICARE FISCAL INTERMEDIARY	:	

CORRECTED JUDGMENT

This cause came to be heard before the Honorable T. Emmet Clarie, Chief United States District Judge for the District of Connecticut, on motion of the defendants for summary judgment and on cross-motion of the plaintiff for summary judgment, pursuant to Rule 56 of the Federal Rules of Civil Procedure, and the Court having considered the affidavits and briefs, and having heard the arguments of counsel, and due deliberation having been made thereon, and having found that the defendants may not lawfully recapture reimbursements for accelerated depreciation taken by the plaintiff from June 29, 1967 through December 31, 1969, and having found that charges recouped subsequently, commencing with January 1, 1970, are lawful, it is

ORDERED, ADJUDGED AND DECREED that the plaintiff recover of the defendants the sum of $15,655.00.

T. EMMET CLARIE
Chief United States District Judge

Dated at Hartford, CT
this 21st day of October, 1975.

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

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U.S. DIST. CT. COURT
HARTFORD, CONN.

SOUTH WINDSOR CONVALESCENT HOME, INC.	:	
v.	:	CIVIL NO. H-74-250
CASPAR W. WEINBERGER, Secretary of Health, Education and Welfare, THE UNITED STATES OF AMERICA, and TRAVELERS INSURANCE COMPANY, MEDICARE FISCAL INTERMEDIARY	:	

NOTICE OF APPEAL

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Second Circuit from the final judgment entered in this action on October 16, 1975.

Dated at Hartford, CT this 11th day of December, 1975.

UNITED STATES OF AMERICA

PETER C. DORSEY
United States Attorney

By Albert J. Dabrowski
ALBERT S. DABROWSKI
Assistant U. S. Attorney

DOJ-1976-02